FACTSHEET

FARM BUSINESS MANAGEMENT

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PAYING WAGES TO FAMILY MEMBERS

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(Replaces Factsheet No. 95-045 "Paying Wages to Family Members")

Farm families have the opportunity to reduce their tax bill and boost their after-tax family income by paying wages or salaries to family members. Any small business may deduct employee wages as a cost of doing business. Paying family members can help the farm business get as many income dollars as possible, taxed at the lowest possible tax rate. For purposes of premiums for Employment Insurance and the Workplace Safety and Insurance Board, it is important to determine if the family member is working as an employee, under a contract of service, or as an independent contractor under a contract for service.

FIRST TIME EMPLOYERS

Hiring people for your farm operation requires accurate bookkeeping for deductions from wages. The first time employer should apply to the Source Deductions Section of the District Taxation office to obtain an employer's number under which all records will be kept and payments made. An employer's kit, which includes tax tables, Canada Pension Plan and Employment Insurance tables, and personal tax credit return (TD-1E) forms, is also available from the Taxation office. Inquiries can be made by telephone or the number and kit can be obtained in person.

ADVANTAGES

Paying wages to children for their work on the farm is a tax deductible expense to the farm business. The family's total income tax bill may be reduced by splitting income among family members.

Canada Pension Plan (CPP) premiums are paid by all individuals who are 18 years of age or older and who are not already collecting CPP benefits, provided their total earnings for the calendar year exceed $3,500. Individuals then become eligible for the retirement and disability benefits provided by the Canada Pension Plan.

The family's interest in the farming operation may increase because of the monetary recognition of children's and spouse's efforts. Children can develop some capital to assist their education, buy a home or to enter the business.

Regular payments of wages to family members can replace such year-end tax reduction strategies as purchasing machinery to claim a depreciation expense.

A spouse, child or individual under 71 years of age with earned income from wages or salaries can open a registered retirement savings plan (RRSP) and make contributions to the plan. There is no minimum age limit on RRSPs. If the plan is started early in the child's life, funds from tax-sheltered growth in the plan can help provide for the child's education or establishment in business, for example, or may be allowed to grow until retirement.

A spouse, while employed in the farm business, who hires someone to look after young children under 14 years old, can deduct child care expenses. Related persons can be hired as child-care givers, provided the connected person is over 18 years of age.

DISADVANTAGES

The amount of paperwork and record-keeping will increase. There are added payroll expenses for the employer, such as federal Canada Pension Plan and Employment Insurance (EI) premiums as well as contributions to the provincial Workplace Safety and Insurance Board. Employer Health Tax premiums are required for payrolls that are in excess of $400,000.

Funds paid out in the form of salaries and bonuses will no longer be under the control of the farm manager unless the funds are borrowed back to help to finance the operation.

TAX SAVINGS

Tax savings can be generated when revenue is divided between several people. This usually happens by directing earnings from a taxpayer whose marginal tax rate is over 50% to one whose tax rate is under 30%.

This should be accomplished within your desired business organization. A farmer operating as a sole proprietor or a corporation can pay a wage to a spouse. Spousal partners can split profits. All three forms of business can pay wages to children who perform work in the business.

Tax savings should be considered a bonus — the biggest payoff is the recognition and rewarding of the important role played by spouses and children.

WAGES AND TAX CREDITS

Dividing the farm's net income among family members in the form of wages will affect tax credits such as the non-refundable tax credits allowed for various categories of family members.

PAPERWORK REQUIRED

When paying a salary to a spouse or child, a considerable amount of paperwork must be completed to comply with Revenue Canada's taxation regulations.

To Start ...

- Obtain an employer registration number from Revenue Canada. This is the employer's account number for submitting payroll deductions.

- Enter into a contract of service to hire the individual as an employee. Specify the work to be done, rate of remuneration, working hours, conditions of employment, benefits and so on.

- Apply for a social insurance number for any employee who does not have one.

- Complete a Personal Tax Credit Return for each employee, form TD1(E). This form tells the employer the appropriate level of tax credits for each employee. As an employer you retain this form on file to ensure the appropriate tax is withheld from the employee's pay cheque.

If in doubt about the status of an employee for EI or CPP purposes, a ruling can be obtained from the Source Deductions section, CPP/EI unit of your Revenue Canada district taxation office. If you as an employer or employee disagree with the ruling, it can be appealed by completing Revenue Canada's form CPT100 Application for Determination of a question or appeal under the Canada Pension Plan or Unemployment Insurance Act.

Each Month ...

- Keep a monthly payroll ledger with detailed information on date of pay period, hours of work, gross pay, taxable benefits, CPP contributions, EI premiums, income tax, advances, deductions, net pay and amounts remitted to Revenue Canada taxation.

- Provide a monthly payroll transaction summary slip to each employee with their pay cheques.

- Submit the monthly remittance on form PD7AR to Revenue Canada Taxation. (Due by the 15th of the following month).

At Year-end ...

- Complete an annual payroll summary from the monthly payroll ledger records.

- Complete T4 Supplementary slips for all employees before February 28 of the following year.

- Submit T4-T4A Summary to Revenue Canada Taxation. This is a summary of all remuneration paid to all employees.

PAYROLL DEDUCTIONS

Farmers using computers to calculate payroll deductions should refer to Revenue Canada's publication Machine Computation of Income Tax Deductions, Canada Pension Plan Contributions and Employment Insurance Premiums (MC tables). Revenue Canada's deduction tables are available on disk and can be obtained through the Internet at Revenue Canada's Small Business Page.

Canada Pension Plan (CPP)

Employee premiums are based on a percentage of the employee's earnings and are matched by the employer.

Salary, wages or other remuneration, commissions, bonuses, and the value of board and lodging (other than exempt allowance for special or remote work sites) are subject to Canada Pension Plan contributions.

Premiums are not required for:

- individuals under the age of 18 or over the age of 70.

- agricultural workers who earn less than $250 and work less than 25 working days in a calendar year.

- employment where no cash remuneration is paid.

Income Tax

Income taxes that are to be withheld are based on gross income (as per code on TD1(E) form.

Employment Insurance (EI) Premiums

The Employee's Premium is based on a percentage of insurable earnings to an annual maximum. Recent changes to EI require that insurable earnings be calculated on the number of hours worked rather than weeks of work. Similarly, qualifying for benefits is dependent on an employee meeting a threshold number of hours worked rather than completing a certain number of weeks of work. A new Record of Employment form reflects these changes.

The Employer's contribution is 1.4 times the amount of the employee's EI premiums to an annual maximum per employee. Employee and employer premiums are required for any individual earning insurable employment income. All employment in Canada, under a contract of service, is insurable employment unless otherwise excepted.

Spouses and family members are considered insurable if they are working in a valid employer/employee relationship under a contract of service similar to one negotiated with someone with whom you deal at "arm's length". If in doubt, obtain a ruling from Revenue Canada as discussed above. Individuals connected by blood relationship, marriage or adoption are considered not at "arm's length".

There is no minimum or maximum age limit for EI premiums. Employed persons over age 65 continue to pay EI premiums.

Employee and employer premiums are not required:

- for employment in agricultural enterprises of less than 7 working days in a calendar year.
- for employment by a corporation of a person who controls more than 40% of issued voting shares.
- where the family member is an independent contractor working under a contract for service.
- where the family member is not dealing with you at "arm's length" and is not working under a valid employee/employer relationship.

Workplace Safety and Insurance Board (WS&IB) Premiums

Employers pay an annual assessment to the WS&IB based on the rate into which they fall and their total annual payroll.

Farm operations are classified into rate groups, depending on the type of farming. Each rate group has a dollar amount assigned to it annually by the WS&IB which reflects the past and expected future costs of injuries and occupational illnesses within that rate group.

The annual assessment to be paid by the employer is calculated by multiplying each $100 of assessable payroll (to the maximum earnings ceiling established in the Act) by the dollar amount assigned to the employer's rate group. NOTE: It is illegal to deduct the cost of premiums from a worker's wages.

A farmer is required to report and register its business with the WS&IB within one month of first hiring employees. Registration can take place in writing or by phone at the nearest WS&IB office.

Annual payroll information for assessment purposes must be filed by April 30 each year.

Failure to register or file payroll information may result in a charge for the full cost of a claim and a late filing charge.

COMMON QUESTIONS

If I hire someone for a few days a year to help with seeding or harvest, do I need to deduct CPP and EI?

No. CPP premiums do not have to be made for employees hired for less than 25 working days in a calendar year.

EI premiums do not have to be deducted for employees who work less than seven days in a calendar year.

Arrangements do have to be made for Workplace Safety and Insurance Board coverage.

Can I pay my spouse's or child's salary once at the end of the year?

Yes, this is possible, provided the payment is actually made and deductions are remitted as required. Don't expect to be able to decide how much you should have paid after the 12 month business year has expired.

Should I pay my employees by cheque?

Yes. Payments should be by cheque and made out for the end of time period covered, i.e., weekly or monthly. The cheque should be deposited in the employee's bank account to indicate the recipient has control over the funds.

What if the farm business can't afford to pay its family members their salaries?

An alternative is to pay the spouse or child the usual salary and have them lend the money back to the employer with a properly documented demand note. An actual cash transaction must take place where the employee receives the money and then lends it or invests it back into the business.

What if I don't like to or don't have time to keep payroll records?

As an employer, you do not have to physically do the records yourself. Accountants or tax filers can help you with payroll deductions. They can help you with the initial calculations and you can complete the monthly procedures yourself, or you can hire them to do all the work related to payroll. However, it is the responsibility of the employer to maintain payroll records for tax purposes and under the provincial Employment Standards Act. (You can also get instructions from the Record of Employment specialist at your nearest Human Resources Canada Centre).

What if I pay my employees in kind rather than in cash?

Payments to employees in kind rather than cash are treated as "non-cash benefits", which are taxable. The fair market value of the payment in kind given to the worker is a benefit to the individual that must be reported on a T4A slip. These benefits are not pensionable and not insurable by the employer, therefore, no CPP and EI deductions are required by the employer.

What if I hire someone on contract, do I need to make payroll deductions?

No. If the contract labourer is a self-employed worker who is hired to do a certain job, it is only necessary to pay their contracted job cost. Custom operators and contract labourers are required to have their own WS&IB coverage as they are considered to be self employed.

In many farm operations, workers are paid as though they were contract labourers, that is, no payroll records are kept and no deductions are made and submitted to Revenue Canada on their behalf. In many cases, these workers are truly employees, therefore, the contract treatment is improper. Revenue Canada can assess whether an employment relationship exists by looking at a number of factors such as the ownership of tools, degree of control over the job, risk of profit or loss to the worker, and availability for other work.

Revenue Canada has recently published a guide to help employees and workers determine their employment status. It is available at tax offices.

When deciding on salary levels for spouse and children, what is reasonable?

Salaries or wages must be of a reasonable amount based on the extent and type of work performed by the family member. Consider what you would pay a non-family member to do the same work.

If my spouse is currently paid as an employee is there any problem in them becoming a business partner later on?

There is generally no problem changing from an employee to business partner as long as you can document to Revenue Canada how the former employee's shares or partnership interest in the business have been acquired or accumulated.

Can my spouse, as a farm employee, in turn hire her mother to look after our young children and deduct the personal child-care expenses while working for me in the farm business?

Child care expenses may be claimed by the spouse with the lowest income. When the care giver is "connected", the connected person must be 18 years of age or older and not claimed as a dependent by the employer. In the case of your spouse hiring your mother-in-law, child care expenses would be deductible in most situations.

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